NOTES

The Supreme Court Attacks the Family Trust

The most successful device for the avoidance of the ever-increasing burden of inheritance taxation has been the trust. Once the pampered favorite of the courts, it has come to be regarded with suspicion where taxation is the issue, since the inevitable result of the creation of a trust is to reduce the amount of the estate or the income of the taxpayer who has created it. This suspicion is heightened when the settlor retains some sort of control over the trust. The enactment that has gone the furthest of all the acts of Congress in its war on this type of tax avoidance is section 302 (d) of the Act of 1926,[1] which provides that there shall be included in the gross estate of the decedent any property of which the decedent "had made a transfer by trust or otherwise, where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power, either by the decedent alone or *in conjunction with any person,* to alter, amend, or revoke. . . . "[2] Considerable speculation arose as to whether the Supreme Court would interpret this literally.[3] The case of *Helvering v. City Bank Farmers Trust Co.*[4] has provided the answer.

In 1930 decedent established a trust in which she reserved the power to revoke in conjunction with the trustee and a beneficiary, the income to be paid to the settlor during her life. The beneficiary survived the settlor, and the Commissioner of Internal Revenue assessed the trust as part of the estate of the decedent under section 302 (d). The Board of Tax Appeals held that the section was inapplicable,[5] and the Circuit Court of Appeals of the Second Circuit affirmed [6] on the ground that Congress had not intended to tax transfers by which the settlor had relinquished control so completely. On certiorari to the Supreme Court the judgment was reversed, four justices dissenting.[7] It was insisted on behalf of the taxpayer that "any person" should be interpreted to mean "any person not a beneficiary", and that otherwise interpreted the statute would be unconstitutional because so arbitrary and capricious as to contravene the provisions of the Fifth Amendment. The Court rejected both contentions.

The Interpretation of the Statute

The Supreme Court determined, long before the inclusion of any provisions for taxation of revocable trusts in the Revenue Acts, that a *sole*

1. 44 Stat. 71 (1926), 26 U. S. C. A. § 411 (d) (1935). This section was substantially unchanged from the Act of 1924, 43 Stat. 304 (1924).
2. Italics added.
3. See Sutter and Owen, *Federal Taxation of Settlors of Trusts* (1935) 33 Mich. L. Rev. 1169; Ryan, *Taxation of Donative Transfers Effective at Death* (1933) 19 Va. L. Rev. 761, 783, 784; Lowndes, *The Constitutionality of the Federal Estate Tax* (1933) 20 Va. L. Rev. 141, 160; Surrey and Aronson, *Inter Vivos Transfers and the Federal Estate Tax* (1932) 32 Col. L. Rev. 1332, 1357; Leaphart, *The Use of the Trust to Escape the Imposition of Federal Income and Estate Taxes* (1930) 15 Corn. L. Q. 587, 603.
4. 80 L. ed. 1 (1935), *rehearing denied,* Dec. 9, 1935.
5. 29 B. T. A. 1141 (1934).
6. 74 F. (2d) 242 (C. C. A. 2d, 1934).
7. Justices Van Devanter, McReynolds, Sutherland and Butler dissented.

power of revocation in the settlor rendered his estate subject to inheritance taxation.[8] The ground upon which these cases went was that the control retained by the settlor made the trust for all practical purposes part of his estate. Congress aimed its first provisions as to revocable trusts against evasions of the income tax. Section 219 (g) of the Act of 1924,[9] provided that the income from a trust would be taxed to the settlor if he reserved a power of revocation in conjunction with anyone *not a beneficiary.*[10] When section 302 (d) was under consideration, the committee left out the extremely pertinent words "not a beneficiary." The committee stated that "this provision is in accord with the principle of section 219 (g)",[11] and from this it was argued on behalf of the taxpayer that to bring the new section into accord with 219 (g), "not a beneficiary" should be read in after the term "any person." But the principle of both sections may just as well be considered to be that taxes should be directed at all property over which the decedent retained control.[12] It was apparently considered by the Congressional committee that even a provision for joint revocation indicated the intention of the donor to exercise some control over the trust, and that evasion could be effected by making the beneficiary one whom the settlor could influence and thus substantially retain the property. It would seem that the committee would have worded the new section in the same terms as 219 (g) had it wanted to create an identical provision. It is undoubtedly true, as pointed out in the brief of the taxpayer, that courts have frequently read words into a statute that a literal construction would not imply.[13] These cases are all based, however, on the grounds that the obvious spirit of the statute required such an interpretation, or the court considered that it was unconstitutional if literally read. It is settled that a statute should be given

8. Bullen v. Wisconsin, 240 U. S. 625 (1916). This case involved the constitutionality of the imposition of an inheritance tax by the state of Wisconsin. See also Saltonstall v. Saltonstall, 276 U. S. 260 (1928), involving the applicability of the Massachusetts tax on transfers passing by future appointment. The court held the power to revoke was equivalent to a power of disposition. A tax on the income from trusts revocable by the settlor alone was upheld in Corliss v. Bowers, 281 U. S. 376 (1930).

9. 43 STAT. 275 (1924), 26 U. S. C. A. § 960 (1928).

10. Italics added. This section was subsequently amended to read "in conjunction with any person *not having a substantial adverse interest* in the disposition of . . . the corpus or the income. . . ." 48 STAT. 729 (1934), 26 U. S. C. A. § 166 (1935).

11. H. R. REP. No. 179, 68th Cong., 1st Sess.

12. See dissenting opinion of Hand, J., in Commissioner of Internal Revenue v. City Bank Farmers Trust Co., 74 F. (2d) 242, 246 (C. C. A. 2d, 1934).

13. See Blodgett v. Holden, 275 U. S. 142 (1927), where Section 319 of the Revenue Act of 1924, 43 STAT. 313, which purported to tax all gifts made during the calendar year 1924, was interpreted by four members of the Court to mean all gifts made subsequent to the enactment of the law; Shwab v. Doyle, 258 U. S. 529 (1922), and Union Trust Co. v. Wardell, 258 U. S. 537 (1922), where a similar construction was made as to the words "has at any time made a transfer," in Section 202 (b) of the Revenue Act of 1916, 39 STAT. 777. In these cases this construction was made to uphold the constitutionality of the Act.

In United States v. Jin Fuey Moy, 241 U. S. 394 (1916), the words "any person" were construed to apply only to the class of persons described in Section 1 of the Opium Registration Act of 1914, 38 STAT. 785. Again the Court considered the constitutionality of the Act otherwise interpreted to be the primary consideration.

In United States v. Kirby, 7 Wall. 482 (U. S. 1868), a statute making it a crime to obstruct the passage of mail was held inapplicable to an officer of the court who arrested the carrier for murder under a bench warrant, as a matter of common sense. In Church of the Holy Trinity v. United States, 143 U. S. 457 (1892), an act to prohibit the importation of foreigners and aliens under contract to perform labor or service of any kind was held inapplicable to an alien entering the United States under a contract with a religious society to act as minister, on the ground that the obvious spirit of the statute demanded such a conclusion.

that interpretation which upholds its constitutionality, and that even a construction that merely throws grave doubts upon its validity should not be rendered.[14] Here, however, the majority of the Court had no doubts of the constitutionality of the Act; having reached such an opinion, a literal reading of the statute followed as a matter of course.[15]

The view of the majority of the Court that even a joint power of revocation is a taxable interest, provides the answer to a similar controversy which arose in the case of *Helvering v. Helmholz,*[16] decided the same day as the *City Bank Farmers Trust Co.* case. This involved the first paragraph of section 302 of the 1926 act, which states that the tax is imposed to the extent of the interest of the decedent. The argument was made by the taxpayer that no "interest" at all existed, but this was rejected by the Court.

THE CONSTITUTIONALITY OF THE ACT AS INTERPRETED

A more doubtful question is presented by consideration of the constitutionality of the statute, when so interpreted. Inheritance taxes are based upon the privilege of transfer or receipt of some interest of the decedent.[17] That this need not be an actual *property* right is shown by the decisions which uphold taxation of trusts in which an absolute power of revocation is reserved to the settlor alone.[18] In such cases there is no actual property right which passes to the beneficiary upon the death of the donor, but "taxation is an intensely practical matter" [19] and it is clear that the trust *res* does not pass finally and absolutely beyond the control of the decedent until his death. At that time the recipient of the property finally avoids all danger of its being taken from him, and thus gains a very real benefit from the death of the settlor. Similar reasoning upholds the taxation of estates held by the entireties, or joint estates,[20] since death occasions the shifting of practical benefits, not before owned, to the survivor. Gifts in contemplation of death go somewhat farther afield from the concept of an interest passing at death, since the gift is irrevocably vested at the time of its completion; but here the emphasis is on the reason for the transfer and the gift is thought so closely connected with the death of the donor, by reason of his testamentary intent,[21] that it may properly be classified with inheritance taxation.[22] Under

14. Panama R. R. v. Johnson, 264 U. S. 375, 390 (1924); United States v. Delaware & Hudson Co., 213 U. S. 366, 407, 408 (1909).

15. Nevertheless, in addition to the lower court opinions of the three cases discussed in this note, Lit v. Commissioner, 72 F. (2d) 551 (C. C. A. 3d, 1934) and Commissioner v. Stevens, 79 F. (2d) 49 (C. C. A. 3d, 1935) also decided that a literal reading of the statute was incorrect. Commissioner v. Strauss, 77 F. (2d) 401 (C. C. A. 7th, 1935), is *contra.*

16. 80 L. ed. 5 (1935).

17. See Knowlton v. Moore, 178 U. S. 41, 47, 56 (1900).

18. See note 8, *supra.*

19. Farmers' Loan & Trust Co. v. Minnesota, 280 U. S. 204, 212 (1930).

20. Tyler v. United States, 281 U. S. 497 (1930), 79 U. OF PA. L. REV. 233; Gwinn v. Commissioner, 287 U. S. 224 (1932). For a similar holding as to community property see Moffitt v. Kelley, 218 U. S. 400 (1910).

21. In Schlesinger v. Wisconsin, 270 U. S. 230 (1926), Mr. Justice McReynolds states, at p. 240, that gifts *inter vivos* "are subjected to graduated taxes which could not properly be laid on all gifts or, indeed, upon any gift without testamentary character." Although this statement has been proven incorrect as to gift taxes in the case of Bromley v. McCaughn, 280 U. S. 124 (1929), it clearly implies that the basis for taxing a transfer at death is its testamentary character.

22. See Milliken v. United States, 283 U. S. 15, 23 (1931). For a compilation of state decisions on this point, see series of annotations in (1920) 7 A. L. R. 1028, (1922) 21 A. L. R. 1335, (1926) 41 A. L. R. 989, (1926) 43 A. L. R. 1229.

the previous cases, then, some "interest" must pass from the decedent at his death, or the transfer must have been motivated by impending death, in order for the transfer to be properly taxed within the classification of inheritance taxation. Congress has of course the power to tax any transfer;[23] the only constitutional issue is as to the proper *exercise* of this admitted power. The real question is the time when the tax may be imposed, which of course determines the value of the interest to be taxed. This is a very real and practical distinction when it is considered that if it were possible to tax at death all transfers made by decedent during his life, the tax would in most cases be unconscionably large due to the graduated system under which the tax is imposed. Also, the property transferred may in many cases have greatly increased in value since the time of the transfer. For this reason, if for no other, it is improper to attempt to impose a death tax upon a fully completed *inter vivos* transfer, not in contemplation of death.

The Supreme Court has clearly indicated that no additional right passes to the recipient of the property upon the death of the settlor where the property was previously transferred to him by an *inter vivos* trust in which the settlor retained a power to revoke in conjunction with that beneficiary. *Reinecke v. Northern Trust Co.*[24] involved the taxation of seven trusts under the Revenue Act of 1921, section 402 (c),[25] providing, substantially as section 302 (c) of the Act of 1926 [26] provides, that gifts in contemplation of death, or intended to take effect in possession or enjoyment at death, should be included in the gross estate of the donor. Two of the trusts contained an absolute power of revocation in the settlor alone, and these the court had no difficulty in holding taxable. But the other five trusts were revocable only by the settlor in conjunction with a beneficiary, and here the Court said: [27]

> "the trust, for all practical purposes, had passed as completely from any control by decedent which might inure to his own benefit as if the gift had been absolute."

The Court goes on to say: [28]

> "The shifting of the economic interest in the trust property which was the subject of the tax was thus complete as soon as the trust was made. His power to recall the property and of control over it for his own benefit then ceased. . . . "

The doctrine of this case has been reaffirmed in *Porter v. Commissioner* [29] and *Reinecke v. Smith*,[30] in differentiating it from other trusts in which

23. See Bromley v. McCaughn, 280 U. S. 124, 137 (1929).
24. 278 U. S. 339 (1929).
25. 42 STAT. 278 (1921).
26. 44 STAT. 70 (1926), 26 U. S. C. A. § 411 (c) (1935).
27. 278 U. S. 339, 346 (1929).
28. *Ibid.*
29. 288 U. S. 436 (1933). The settlor of a trust reserved the right to alter or modify in any way, excepting any change in favor of himself or his estate. The Court held section 302 (d) applicable, distinguishing Reinecke v. Northern Trust Co. by the fact that the trusts were beyond decedent's control in the latter case, where revocable only with a beneficiary.
30. 289 U. S. 172 (1933). The case involved the taxability of income from a trust revocable by the settlor and either of two trustees under section 219 (g) of the Act of 1924. The Court discussed Reinecke v. Northern Trust Co. and approved the doctrine that the trusts could not be taxed as property of the settlor because of the absence of control in him.

the settlor retained more control. Although the statute involved in *Reinecke v. Northern Trust Co.* is essentially different from that involved in the instant case, the case is a direct holding to the effect that a trust revocable by the settlor only in conjunction with a beneficiary is no longer within the control of the settlor, and that nothing can pass by reason of his death. Mr. Justice Roberts is far from denying this:[31] "The case involved nothing more than a determination whether the transfers were complete when made."

He then goes on to state that here we have a different problem, since section 302 (d) "on its face embraces Mrs. James's transfer, although complete when made and thereafter beyond her unfettered control." The problem is of course different, since the question there was whether the trusts could be included in the estate of the settlor under the terms of section 402 (c), while here the question is whether, with that holding in mind, it can be said that the statute specifically including this trust is so arbitrary and capricious as to be violative of the Fifth Amendment.

Statutes creating a presumption that gifts made within an arbitrary period before death have been made in contemplation of death have been held so arbitrary and capricious as to deny due process of law to the taxpayer.[32] From the language of the instant case it would appear to be logical to assume that a similarly arbitrary assumption is made here. The reason for the imposition of this tax is apparently that it is assumed that the beneficiary is one over whom the donor has such influence that the transfer is a mere attempt to evade the statute, and is not intended to be a *bona fide* transfer. Mr. Justice Roberts so indicates:[33]

> "The purpose of Congress in adding clause (d) to the section as it stood in an earlier act was to prevent avoidance of the tax by the device of joining with the grantor in the exercise of the power of revocation someone whom he believed would comply with his wishes. Congress may well have thought that a beneficiary who was of the grantor's immediate family[34] might be amenable to persuasion or be induced to consent to a revocation in consideration of other expected benefits from the grantor's estate. Congress may adopt a measure reasonably calculated to prevent avoidance of a tax."

Without this assumption it is difficult to see any ground for taxation according to the dogma that an inheritance tax is based upon the transfer of some interest or economic benefit at death. This does not appear to be a less arbitrary assumption than the one that a transfer made within a set period was made in contemplation of death. Mr. Justice Roberts answered the claim that this is an attempt to tax a previously completed transfer by stating that Congress has the right to use any means that are reasonably connected with the exercise of the admitted power to tax interests passing at death, and

31. 80 L. ed. 1, 3 (1935).

32. Heiner v. Donnan, 285 U. S. 312 (1932); Schlesinger v. Wisconsin, 270 U. S. 230 (1926).

33. 80 L. ed. 1, 4 (1935).

34. This language raises the question of whether the Court would hold the statute constitutional if the beneficiary with whom the settlor had the power to revoke were not a member of the grantor's family. It might be considered that this did not threaten illegal avoidance of the tax, and hence the statute would not be a reasonable means of preventing avoidance in such a case.

that this prohibits evasion. This same argument was advanced in the case of *Schlesinger v. Wisconsin,*[35] involving a Wisconsin tax which created a presumption that gifts made within six years of death had been made in contemplation of death. The Court there stated: "Rights guaranteed by the Federal Constitution are not to be so lightly treated; they are superior to this supposed necessity." [36] Where there is in fact control, an inheritance tax is properly laid; where there is none, and the beneficiary gains no added benefit from the settlor's death, all established theories of the basis for an inheritance tax prohibit its imposition. The instant Court has admitted that there is no control in this case; and it is difficult to see any benefit to the beneficiary in the death of the settlor, since all he need do to retain the benefit of the trust is to refuse to revoke on demand of the settlor. An assumption that the beneficiary is subservient to the desires of the settlor seems wholly arbitrary.

It has been suggested that the implications to be drawn from the case of *Burnet v. Wells,*[37] carried to their logical extremity, will mean the end of the family trust as a means of avoiding the inheritance or income tax.[38] That case held that the income from unalterable and irrevocable trusts established for the payment of premiums on insurance policies on the life of the settlor, payable to various relatives of the settlor, may be taxed as part of his income.[39] An indication that this policy would not be extended is to be found in the case of *Hoeper v. Commissioner,*[40] where a statute attempting to evaluate a taxpayer's income tax upon his own and his wife's combined incomes was held unconstitutional. But the implications to be drawn from *Helvering v. City Bank Farmers Trust Co.* go vastly farther than those of the *Burnet* case. Since the acquiescence of the beneficiary amounts to a return of the property to the settlor in the case where the power of revocation is held jointly by the settlor and the beneficiary, it could logically be held that *any* trust for a member of the settlor's family could be taxed as part of the estate of the settlor since it might have been given on the condition that he return it on request. At least three members of the Court would very probably assert that this was a valid means of preventing avoidance of the inheritance tax.[41] Some light is thrown on their attitude by the case of *Helvering v. Helmholz,*[42] decided the same day.

In that case the settlor established a trust in 1918 which was to terminate upon the written agreement of all the beneficiaries, of whom the settlor was one. The trust funds had been provided by the settlor and the other beneficiaries, and upon a. termination agreement the corpus was to return to its various sources. The government attempted to place an estate tax on the settlor's share of the trust under section 302 (d). It was held that the section did not apply, but three justices concurred in the result solely on the ground that since the trust was created prior to the enactment of the

35. 270 U. S. 230 (1926).
36. *Id.* at 240.
37. 289 U. S. 670 (1933). Four justices dissented.
38. See Sutter and Owen, *supra* note 3, at 1185.
39. The Court reasoned that the payment of the policies was a normal expense of the taxpayer, and therefore he was the one to get the benefit from the income of the trusts.
40. 284 U. S. 206 (1931).
41. Mr. Justice Cardozo, Mr. Justice Brandeis, and Mr. Justice Stone.
42. 80 L. ed. 5 (1935).

statute, taxing the settlor would be giving the statute an illegal retroactive effect.[43] The theory of the majority of the Court was that there was no power to revoke reserved to the settlor, since all the beneficiaries of a trust can always terminate; the provision in the trust agreement was regarded as merely expressive of the already existing law. Although there is a factual difference between revocation in conjunction with one beneficiary and revocation by all the beneficiaries,[44] no such distinction is drawn in section 302 (d), nor is any indicated by the opinion in the *City Bank Farmers Trust Co.* case. Had it not been for the retroactive effect of the statute in the *Helmholz* case, three concurring justices would have held the settlor liable to taxation. The underlying factor seems to be the power of the settlor to influence the beneficiary or beneficiaries to agree to return the property to him. If it be constitutional to tax the interests in these cases as passing at the settlor's death, it would seem equally proper to apply an estate tax to the "interest" of a person establishing an outright trust, with no provision at all for revocation, for a member of his family; the beneficiary might be induced to renounce his claim. Stress was also made of the fact that the provision was for "termination" and not for revocation, but the fact remains that the settlor's share of the corpus was to revert to the settlor in case of such termination, so that the effect was the same as though "revocation" had been the term used.

Another case decided the same day as those discussed above was *White v. Poor*,[45] which involved the applicability of section 302 (d) to a trust where the power to terminate was given to all of the acting trustees of a trust created in 1919. The settlor was a trustee at the time of her death, although she had resigned at one time for a period of a year, and had then been reappointed. It was held that the section did not apply since the settlor did not retain her joint power to revoke by reason of any power reserved in the trust instrument, but by reason of her appointment. Again three members of the Court concurred in the result apparently for the sole reason that the statute would be retroactively applied as to this trust. The case is technically distinguishable on two grounds from *Helvering v. City Bank Farmers Trust Co.* The power was to "terminate" rather than "revoke" and section 302 (d) applies only to the power to "alter, amend or revoke". But on termination it was provided that the corpus should revert to the settlor, so that the distinction is one of shadow. Also, the settlor did not expressly reserve the power to *herself*, but merely to the trustees, of which she happened to be one. Very clearly the purpose of the act is far from being carried out by this holding. There is infinitely more control than in the case of *Helvering v. City Bank Farmers Trust Co.*, since the trustees have no interest

43. Mr. Justice Brandeis, Mr. Justice Stone, and Mr. Justice Cardozo were the concurring justices. It would appear to be tacit from the form of their concurrence that they disapproved the general reasoning in the majority opinion.

44. It would appear that all of the interested parties to a trust can revoke it in many jurisdictions [see 4 BOGERT, TRUSTS AND TRUSTEES (1935) § 993], while one beneficiary cannot, of course, effect a revocation in derogation of the rights of the others. Hence, in such jurisdictions, the difference would appear to be more than factual; where the power to revoke or alter is reserved to the settlor in conjunction with *all* the beneficiaries, no added right is reserved; but where reserved in conjunction with only one or a majority, the reasoning of City Bank Farmers Trust Co. is valid.

45. 80 L. ed. 8 (1935).

adverse to the settlor. It has been established that a power reserved to the settlor to revoke in conjunction with a trustee is such a reserved power as will justify a trust being taxed as passing in possession and enjoyment by virtue of death.[46] Stress was made of the fact that the settlor was trustee by virtue of the appointment rather than by reservation in the instrument. As a method of avoiding the strict application of section 302 (d) the subterfuge would not be difficult to arrange. This distinction, it may be admitted, is justifiable under the terms of the statute, but a continuation of the present attack by Congress upon tax avoidance will undoubtedly fill this gap in the future. For the present it is necessary only for the trust instrument to provide for termination rather than revocation, the corpus reverting to the settlor upon such termination, and to place the power of termination in the trustees. In this way section 302 (d) may be avoided and at the same time control may be substantially retained by the settlor.

Helvering v. St. Louis Union Trust Co.[47] arose under section 302 (c) of the Revenue Act of 1924,[48] which provides:

> "The value of the gross estate of decedent shall be determined by including the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated . . . (c) To the extent of any interest . . . with respect to which [the decedent] has at any time created a trust, in contemplation of or intended to take effect in possession or enjoyment at or after his death . . . "

Decedent established a trust to pay the income to his daughter during her life, then to the children of the daughter. It contained a provision that if the daughter should predecease the settlor the corpus should revert to him. The daughter survived the settlor, and the commissioner determined that the trust should be included within his estate. The Board of Tax Appeals held the section inapplicable,[49] and this was affirmed by the Circuit Court of Appeals[50] and the Supreme Court, on the ground that the transfer was complete when made and nothing passed by virtue of death. The Chief Justice rendered a dissenting opinion in which three other members of the Court joined. This dissent was based on the argument that the possibility of reverter retained by the settlor was a valuable interest which in effect prevented the final passing of the property until his death, and that the common law distinction between vested and contingent interests was immaterial for tax purposes. It is obvious that if the settlor had provided that the property should go to his daughter only on condition that she should survive him, that the property would have passed by virtue of his death, and the statute would have been applied.[51] The distinction between the two

46. Saltonstall v. Saltonstall, 276 U. S. 260 (1928). See Reinecke v. Smith, 289 U. S. 172 (1933), to the effect that a trustee does not owe a duty to the *cestui que trust* to refrain from revoking the instrument and that he is not a "beneficiary" within the meaning of section 219 (g) of the Act of 1924.

47. 80 L. ed. 49 (1935); see also Becker v. St. Louis Union Trust Co., 80 L. ed. 54 (1935).

48. 43 STAT. 304 (1924), 26 U. S. C. A. § 411 (1935).

49. 28 B. T. A. 107 (1933).

50. 75 F. (2d) 416 (C. C. A. 8th, 1935).

51. Klein v. United States, 283 U. S. 231 (1931), holding the similar provisions of section 402 (c) of the Revenue Act of 1918 applicable.

estates is no longer of practical value, and if the question were one of first impression it would not be an extraordinary result to find the Court, in the frame of mind indicated by the *City Bank* case, holding the statute applicable. This is particularly true in view of language previously used by the Court in referring to the power of succession of the recipient of property: [52]

> " . . . in determining whether it has been so exercised, technical distinctions between vested remainders and other interests are of little avail."

The precise point was previously presented to the Court in the case of *Helvering v. Duke*,[53] where the Board of Tax Appeals had held that a trust containing a possibility of reverter in the settlor should not be taxed to the settlor,[54] and the Circuit Court of Appeals affirmed.[55] In the Supreme Court the judgment was affirmed by an equally divided Court, Mr. Chief Justice Hughes not sitting. The majority in the *St. Louis Union Trust Co.* case distinguished the similar case of *Klein v. United States* [56] on the ground that there the remainder was vested in the settlor subject to divestment, so that the interest of the beneficiary did not become vested until the death of the settlor. Mr. Justice Stone thought the cases indistinguishable on principle.[57] As far as completeness of transfer is concerned, the beneficiary does not gain an indefeasible title until the death of the settlor, since his death prior to the death of the latter will revest title in the settlor. Hence the beneficiary undoubtedly gains economic benefits from the death of the settlor. As against this is the doctrine of the common law that a possibility of reverter does not affect the completeness of a transfer; title passed beyond the control of the settlor by his first transfer to the trustee. The question is a close one, but one would not expect a court that had decided *Helvering v. City Bank Farmers Trust Co.* to have difficulty in holding it taxable. Looking "to substance, not to form",[58] as Mr. Justice Stone did in his dissenting opinion, something *does* pass by reason of the death of the settlor.[59] But applying the same philosophy to *Helvering v. City Bank Farmers Trust Co.,* one finds that the power of revocation is in fact no power at all, but merely a provision for the return of the property by the beneficiary, unless a completely arbitrary presumption (that the beneficiary is one who will be subservient to the will of the settlor) is adopted. A contrary result in *Helvering v. St. Louis Union Trust Co.* would not go so far as the *City Bank* case. It is surprising to find Mr. Justice Roberts, writer of the opinion in the latter case, leading the way to the somewhat inconsistent holding in the former.

The way would now appear to be open for Congress to stop all present gaps in the inheritance tax laws. A statute including trusts revocable by the

52. Saltonstall v. Saltonstall, 276 U. S. 260, 271 (1928).
53. 290 U. S. 591 (1933).
54. 23 B. T. A. 1104 (1931).
55. 62 F. (2d) 1057 (C. C. A. 3d, 1933).
56. 283 U. S. 231 (1931).
57. See Helvering v. St. Louis Union Trust Co., 80 L. ed. 49, 53 (1935).
58. Dissenting opinion of Mr. Justice Stone.
59. It was argued in the brief of the taxpayer that the only interest passing from the decedent was a possibility of reverter, which was incapable of evaluation. In view of the first paragraph of section 301, which taxes the *interest* of the decedent, there would appear to be some merit in the contention, were it not for the City Bank Farmers Trust Co. case; but there the "interest" retained was held to include the entire value of the property, and it is probable that, had the Court determined that something passed here by reason of death, the tax would have been imposed on the basis of the entire value of the property.

trustees would certainly be upheld as a reasonable exercise of Congress' undoubted power to tax estates and to prevent avoidance of such taxes. The Court may reconsider its stand on the *St. Louis Union Trust Co.* case if Congress attempts expressly to tax possibilities of reverter. While *White v. Poor, Helvering v. Helmholz* and *Helvering v. St. Louis Union Trust Co.* leave present openings in the existing inheritance tax laws, the probability that they will long provide a means of tax avoidance is slight indeed.

T. R. W., Jr.

McCandless v. Furlaud: the End of the Doctrine of Old Dominion Copper Co. v. Lewisohn?

The decision of the United States Supreme Court in the case of *Old Dominion Copper Co. v. Lewisohn* [1] in 1908 has provoked a great deal of periodical literature on the subject of corporate promoters' profits.[2] The principal point of controversy concerning that case was the Court's denial of promoters' liability with respect to prospective shareholders. It now appears that this type of substantial limitation on the liability of promoters has come to an end with the decision by the Supreme Court in *McCandless v. Furlaud.*[3] Dissenting Justice Roberts observes that " . . . the decision now made in effect overrules the *Old Dominion* case",[4] and a close examination of the facts and opinions is accordingly in order. This is particularly advisable since the *Furlaud* case presents an amazing example of the intricate corporate maneuverings which can be devised to mulct the investing public.

Facts

About thirty-five years after promoters Bigelow and Lewisohn initiated the corporate existence of the Old Dominion Copper Mining and Smelting Company,[5] Maxime H. Furlaud, an equally ingenious entrepreneur, organized the Duquesne Gas Corporation.

Furlaud was president and principal shareholder of an investment banking house, Furlaud & Company, Inc. Kingston corporation was a subsidiary of the Furlaud corporation, being solely controlled by the Furlaud interests. For $45,510 Furlaud corporation procured options to purchase Pennsylvania gas fields, the options running in the name of Kingston corporation.[6] The purchase price of these lands was $2,572,989. Their fair

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1. 210 U. S. 206. A collection of cases on "Promoters' Transactions" centering around The Old Dominion Company cases appears in FREY, CASES AND STATUTES ON BUSINESS ASSOCIATIONS (1935) 114-150.

2. For a few good discussions, see Weston, *Promoters' Liability: Old Dominion v. Bigelow* (1916) 30 HARV. L. REV. 39; Brockelbank, *The Compensation of Promoters* (1934) 13 ORE. L. REV. 195; Note (1933) 81 U. OF PA. L. REV. 746; Note (1934) 22 CALIF. L. REV. 326. And see generally EHRICH, THE LAW OF PROMOTERS (1916).

3. 56 Sup. Ct. 41 (1935).

4. *Id.* at 53.

5. The Dominion Co. was organized on July 8, 1895. See Old Dominion Copper Co. v. Lewisohn, 210 U. S. 206, 210 (1908). The Duquesne Gas Corporation was formed in February, 1930. See McCandless v. Furlaud, 56 Sup. Ct. 41, 43 (1935).

6. According to the report of the case in the Circuit Court of Appeals "some of these options were taken in the name of an individual and later assigned to the Kingston Corporation." See McCandless v. Furlaud, 75 F. (2d) 977, 978 (C. C. A. 2d, 1935).

value was about \$2,700,000. Purposely inflated engineers' appraisal of the lands gave their value as \$7,000,000. In furtherance of the promotion scheme the Duquesne Gas Corporation was formed as a Pennsylvania corporation, having an authorized capital stock of 1000 no-par common shares. With an outlay of \$500, Furlaud corporation bought the whole issue at 50¢ per share.[7] Furlaud men became the sole shareholders and directors of the new enterprise. The increase of the capital stock was to come afterwards. By newspaper advertisement public subscriptions were invited to a \$4,000,000 6 percent mortgage bond issue and a \$1,000,000 6½ percent mortgage note issue of the new Duquesne Gas Corporation; the marketing of the securities was to be done through the medium of a banking syndicate formed for that purpose. About a month after the Duquesne corporation came into existence its authorized capital stock was increased by the directors to 1,250,000 shares.[8] One hundred and thirty-nine thousand of these shares were bought by Furlaud corporation at 50¢ per share.

Artificial appraisal of the gas land value; formation of Duquesne corporation as fountain head of the scheme; solicitation of public investments; increase of Duquesne's authorized capital stock—all these had been completed. Only a few more steps were necessary before the tapping of the public wallet could actually begin.

An agreement was then made by Duquesne corporation with its Kingston brother to buy the gas lands as soon as the latter obtained title.[9] Kingston corporation was to pay the individual owners of these lands \$2,572,989 for title. And under the Duquesne-Kingston agreement, Duquesne corporation was to pay Kingston *for the same lands* \$3,015,000 in cash,[10] bonds of \$1,300,000 par value which were to be issued as an encumbrance on the lands when Duquesne took title, and 535,000 no-par shares of its now increased capital stock. To get the cash to pay Kingston for title to the lands, Duquesne corporation agreed to sell all of its forthcoming mortgage notes (\$1,000,000 worth) and \$2,700,000 of its forthcoming mortgage bonds—*to Furlaud corporation.*

But how was Kingston corporation to get the necessary \$2,572,989 to pay the owners for the gas tracts and set the enterprise in motion? And how was Furlaud corporation to get \$3,379,500 in cash (the amount to be paid to Duquesne for its notes and bonds), so that Duquesne would have the necessary cash to pay Kingston for transfer of the title to the lands? The money of the investing public would not be available in payment of the subscriptions to the forthcoming bond and note issue "till the bonds with the deed of trust were ready for delivery, and delivery was impossible until Duquesne, the mortgagor, had title to the fields." [11] But promoters' ingenuity worked "out a plan that would synchronize the two transactions, the cashing

7. The price of 50¢ a share was "authorized by the board of directors of the Duquesne Gas Corporation." *Ibid.*

8. At the same time that the increase in capital stock was authorized, the issuance of the bond and note issue was authorized. *Ibid.*

9. It was "an agreement of reorganization" whereby the Kingston corporation "agreed it would cause the optioned properties, all its assets other than cash, to be transferred to the Duquesne Gas Corporation. . . ." *Ibid.*

10. This cash was in reality an assumption of an obligation of the Kingston corporation to a bank in that amount. *Ibid.*

11. McCandless v. Furlaud, 56 Sup. Ct. 41, 44 (1935).

of the subscriptions and the payments for the lands." [12] A one-day bank credit was arranged to take care of the Kingston ($2,572,989) cash need and the Furlaud ($3,379,500) cash need.

And as Justice Cardozo graphically narrates:[13] "The appointed day arrived. Kingston drew against the credit . . . set up in its favor, . . . " Title passed to Kingston; then to Duquesne. The Duquesne bond and note issue was released.[14] The public cash in payment for the subscriptions to the bond and note issue was delivered [15]—more than enough to take care of the bank loans represented by the one-day credit. And "Duquesne had the ownership of gas fields, worth at cost about $2,500,000, though extravagantly appraised at many millions more. It had also $365,000 working capital. True, it had received $3,379,500 [from Furlaud corporation for the bonds and notes], but it had paid out at once $3,015,000 [to Kingston for title to the lands as per the Duquesne-Kingston agreement]. . . . These are the credit items that any balance sheet must show. The liabilities were the bonds and notes and the no-par shares of stock. The bonds and notes, when distributed to the public, became liens for $5,000,000, more than $2,000,000 in excess of the cost of all the assets with working capital included. The shares of stock, issued in vast quantities, had nothing of substance back of them. . . . The bonds and notes, instead of being used by Furlaud and its allies for the benefit of Duquesne, were disposed of as their own and at a large profit to themselves. . . . [In fact, about three-fifths of the money was applied to the designated uses, the rest being kept for the use of the promoters.] Less than two years later the victimized company was in the hands of a receiver." [16]

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12. *Ibid.*

13. *Ibid.*

14. As soon as the Furlaud corporation delivered its check to Duquesne drawn on the one-day bank credit in payment for its share of Duquesne's bonds and notes, the securities were immediately delivered to the Furlaud corporation. McCandless v. Furlaud, 75 F. (2d) 977, 979 (C. C. A. 2d, 1935).

15. The banking syndicate had organized both a "distributing group" of security dealers and a "secondary distributing group" to effectuate rapid disposition of the bonds and notes. *Ibid.* The issue is described in the opinion as a "spectacular success." 56 Sup. Ct. 41, 43.

16. McCandless v. Furlaud, 56 Sup. Ct. 41, 44 (1935). An attempt has been made to prepare, from a collection of the figures appearing in the Court's opinions, balance sheets showing the financial picture of Duquesne Gas Corporation at various stages of the promoters' manipulations:

BALANCE SHEET #1—Statement of Financial Condition of Duquesne Gas Corporation on its formation with the originally authorized capital stock of 1000 no-par shares.

ASSETS		
Current Assets		
Cash (received from Furlaud)	$500.00	
LIABILITIES AND CAPITAL		
Capital Stock		
1000 shares, no-par value (issued to Furlaud)	$500.00	

BALANCE SHEET #2—Statement of Financial Condition of Duquesne Gas Corporation after Amendment of originally authorized capital stock to 1,250,000 no-par shares.

ASSETS		
Current Assets		
Cash (received from Furlaud)	$ 500.00	
Subscription receivable (from Furlaud)	69,500.00	
Total Current Assets		$70,000.00

McCandless as receiver of Duquesne corporation sued the corporate promoters, Kingston corporation (Furlaud & Co., Inc., had been dissolved),

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LIABILITIES AND CAPITAL

Capital stock		
Authorized capital stock	1,250,000 shares	
Less: Capital stock unissued	1,110,000 shares	
Subscribed and Issued	140,000 shares	$70,000.00
Consisting of		
Furlaud Subscriptions of	1,000 shares	
	139,000 shares	
	140,000 shares	

BALANCE SHEET #3—Statement of Financial Condition of Duquesne Gas Corporation showing the fraudulent appraisal value of the lands. Bonds and notes not yet distributed to the public. Corporation still in a state of "technical solvency." *Cf.* Note (1926) 26 COL. L. REV. 447, 452.

ASSETS

Current Assets		
Cash		
From Furlaud for bonds	$2,430,000.00	
" " " notes	880,000.00	
" " " originally authorized capital stock	500.00	
" " " subscription to increased authorized capital stock	69,500.00	
Total Current Assets		$3,380,000.00
Fixed Assets		
Gas lands (fraudulent appraisal value)		7,000,000.00
Total Assets		$10,380,000.00

LIABILITIES AND CAPITAL

Current Liabilities			
Due Kingston Corp. for lands			$3,015,000.00
Fixed Liabilities			
Notes payable (6½%) due Furlaud		$1,000,000.00	
Bonds payable (6%)			
due Furlaud		2,700,000.00	
due Kingston		1,300,000.00	
Total Fixed Liabilities			$5,000,000.00
Capital Stock			
Authorized capital stock		1,250,000 shares	
Less: Capital stock unissued		575,000 shares	
Issued and Outstanding capital stock		675,000 shares	2,365,000.00*
consisting of:			
to Furlaud	140,000 shares		
to Kingston	535,000 shares		
	675,000 shares		
Total Liabilities			$10,380,000.00

Note: Working capital ($365,000) equals current assets ($3,380,000) minus current liabilities ($3,015,000).

*This figure was obtained by subtracting total current and fixed liabilities from total assets.

BALANCE SHEET #4—Statement of Financial Condition of Duquesne Gas Corporation showing actual value of land and corporate financial condition after bonds and notes were issued to public and "after all the circuits had been traveled." Corporation actually insolvent.

and others for an accounting of the allegedly unlawful profits. The Federal District Court [17] gave a decree against the defendants, awarding damages to the receiver of $1,554,779.73 with interest, "which was the difference between the moneys realized by the promoters through the sale of bonds and notes . . . , and the amount paid to Duquesne and devoted to its proper uses . . . ." [18] The defendants were held *not* liable for any gains arising from the disposition of the no-par shares. The substance of the lower court decision granting a recovery was based on the fraudulent appraisal of the value of the gas lands, making "the proceeds of the subscriptions . . . chargeable with a trust for the benefit of Duquesne and the holders of its mortgage debt.[19] The Circuit Court of Appeals for the Second Circuit [20] reversed the District Court, posing their decision of no liability squarely on the doctrine of *Old Dominion Copper Co. v. Lewisohn*. On writ of cer-

ASSETS			
Current Assets			
Cash			
From Furlaud for Bonds		$2,430,000.00	
" " " Notes		880,000.00	
" " " Originally Authorized Capital Stock		500.00	
" " " Subscription to increase Authorized Capital Stock		69,500.00	
Total Original Cash			$3,380,000.00
Less: Disbursed to Kingston in payment for lands			3,015,000.00
Total Current Assets			$ 365,000.00
Fixed Assets			
Gas lands (at the lower of cost or market value)			2,572,989.00
Total Assets			$2,937,989.00
LIABILITIES AND CAPITAL			
Fixed Liabilities			
Notes Payable (6½%)—Due Furlaud		$1,000,000.00	
Bonds Payable (6%)—		4,000,000.00	
Due Furlaud	$2,700,000.00		
Due Kingston	1,300,000.00		
	$4,000,000.00		
Total Fixed Liabilities			$5,000,000.00
Capital Stock			
Authorized Capital Stock	1,250,000 shares		
Less: Unissued Capital Stock	575,000 shares		
Issued and Outstanding	675,000 shares	no-par value	*2,062,011.00**
Total Liabilities and Deficit			$2,937,989.00

*This is a minus figure showing the "surplus-deficit." Since the fixed liabilities are in excess of the total assets, the value of the capital stock is to that extent a negative one. This represents the approximate amount of watered value in the promoter's appraisal of the gas lands. See Balance Sheet #3.

17. The case in the District Court is commented upon in (1933) 33 COL. L. REV. 1065.

18. McCandless v. Furland, 56 Sup. Ct. 41, 45 (1935).

19. *Ibid.*

20. 75 F. (2d) 977 (C. C. A. 2d, 1935). The instant case had had a previous hearing in the Circuit Court of Appeals, the bill being dismissed "on the ground that the appointment of the ancillary receiver was void for want of jurisdiction. 68 F. (2d) 925 (C. C. A. 2d, 1934)." 56 Sup. Ct. 41, 45 (1935). The United States Supreme Court in 293 U. S. 67 (1934) reversed the Circuit Court ordering a determination of the merits.

tiorari, the United States Supreme Court reversed the Circuit Court of Appeals by a five-to-four vote, affirming the District Court's holding with the modification that the defendants should be liable even for the gains resulting from the disposition of the no-par shares, representing an additional recovery of some $1,275,000. Mr. Justice Roberts filed a vigorous dissenting opinion, with Justices McReynolds, Sutherland and Butler concurring.

MAJORITY OPINION: CARDOZO, J.

Characteristic writing and thinking mark the majority opinion: "Promoters of a corporation stand in a fiduciary relation to it to this extent at least, that they will be chargeable as trustees if they deal with it unconscionably . . . or in violation of a statute, unless the liability for such misconduct has been effectually released." [21]

Old Dominion Copper Co. v. Lewisohn is distinguished from the *Furlaud* case in definite terms. These distinctions will be discussed later.

In placing full responsibility on the promoters a number of considerations are particularly emphasized by the Court:

(1) The effect of the promoters' conduct is said to saddle Duquesne corporation with practical insolvency, or at least actionably to reduce the creditors' protective buffer "at the outset of its business life." [22] Hence the interests affected here are the creditors' rights not to have the corporate assets wrongfully impaired to their detriment. The instant suit is to redress such a wrong.

(2) Only three-fifths of the public moneys solicited was applied to corporate uses; the promoters pocketed the other two-fifths.[23]

(3) The conduct of the promoters was violative of a Pennsylvania constitutional provision forbidding fictitious bond or stock issues [24] (Duquesne corporation being of Pennsylvania origin) since cases hold that the constitutional prohibition "is not escaped through the receipt of some property or money if the amount or value is inadequate".[25]

(4) Imminently prospective creditors—namely, the bondholders and noteholders who were represented by the plaintiff receiver—are to be treated as existing creditors for the purpose of being protected against the corporate approval of the promoters' wrongful conduct

21. 56 Sup. Ct. 41, 45 (1935).

22. See balance sheets 3 and 4 in note 16, *supra*.

23. In the Lewisohn case innocent public subscribers were lured into a corporate promotional enterprise to the extent of only a 2/15 proportion of the total investment involved; the Court refused to hold the promoter liable. In this case, where the inveigled public supplied the total corporate investment, and the promoters personally pocketed 6/15 of the investment, the promoters were called to account.

24. "No corporation shall issue either stocks or bonds except for money, labor done, or money or property actually received; and all fictitious increase of stock or indebtedness shall be void." PA. CONST. (Purdon, 1930) art. XVI, § 7. See also PA. STAT. ANN. (Purdon, 1930) tit. 15, § 131.

25. 56 Sup. Ct. 41, 48 (1935), citing the following decisions: Commonwealth v. Reading Traction Co., 204 Pa. 151, 53 Atl. 755 (1902); Big Spring Electric Co. v. Kitzmiller, 268 Pa. 34, 38, 110 Atl. 783, 784 (1920); *In re* Wyoming Valley Ice Co., 153 Fed. 787 (M. D. Pa. 1907), *aff'd sub nom.* Wiegand v. Albert Lewis Lumber Mfg. Co., 158 Fed. 608, 609, 610 (C. C. A. 3d, 1908).

manifested by the shareholders and directors.[26] Such consent "can never be operative to the prejudice of others where consent is in derogation of the public policy of the state or the prohibition of a statute."

(5) The transaction was considered as a unit, " . . . infected with a common vice. Everything of profit arising out of the abused relation must now be yielded up." [27] This includes profits and proceeds from the no-par shares as well as from the bonds and notes.

DISSENTING OPINION: ROBERTS, J.

Justice Roberts' dissent is based almost entirely on the limiting principles set up in the *Lewisohn* case. The bonds, notes, and shares were transferred by Duquesne to the promoters, and it was later that the promoters passed them on to the unsuspecting public. The promoters themselves being the only existing creditors and shareholders at the time of their fraud, the corporation had no cause of action against the promoters due to the "assent" of all the then existing shareholders and creditors. It was accordingly urged that the public subscribers should be remediless save for their individual deceit actions against the defendant promoters. Although the Lewisohn case had involved no potential creditors, this is thought by the dissenters not to be a valid basis for differentiation.

A minor complaint against the majority result of recovery added that granting damages to the receiver would inure to the benefit of the general creditors of the corporation, as well as to the bond and noteholders, the general creditors being people to whom the promoters were under no obligation.[28]

Though Mr. Justice Roberts' fealty to the *Lewisohn* doctrines is unswerving, it cannot but be noticed that he too recognized its serious shortcomings: "I concur in the view that the promoters of Duquesne Gas Corporation took an unconscionable profit which they reaped at the expense of a credulous and avid purchasing public. This fact, however much it may invite animadversion, ought not to induce the courts to disregard settled principles in an effort to deprive the [defendants] of the fruits of their scheme." [29]

THE *Lewisohn* CASE COMPARED

As early as 1913 it was intimated that the Supreme Court had regretted its stand in the *Lewisohn* case by its step away from the doctrine in the case of *Davis v. Las Ovas Co., Inc.*[30] That the intimation has become an outspoken regret is relatively clear from the opinions of both the majority and dissenting justices in the *Furlaud* case. But before hailing the decision as

26. *Cf.* Note (1934) 22 CALIF. L. REV. 326.

27. 56 Sup. Ct. 41, 49 (1935).

28. For contrasting points of view about the damages aspect of recoveries in promoters' transactions compare Weston, *Promoters' Liability: Old Dominion v. Bigelow* (1916) 30 HARV. L. REV. 39. And *cf.* note (1934) 47 HARV. L. REV. 1031 with note (1931) 26 ILL. L. REV. 340, 341. See also Brockelbank, *The Compensation of Promoters* (1934) 13 ORE. L. REV. 195, and especially 204-212.

29. Instant case at 50, 51.

30. 227 U. S. 80 (1913) discussed in Note (1926) 26 COL. L. REV. 447, 451, and in Brockelbank, *supra* note 2, at 212. In this case there was not a full disclosure by one group of promoters to another group of promoters at the time of the sale, and the Court held the first promoters liable.

a complete reversal, certain factors should be noted by virtue of which it is possible to distinguish the two cases.

In determining promoters' responsibility, there are a number of operative facts which courts generally regard. One may be described as the intention of the promoter in acquiring the property which he transferred to the corporation.[31] In the *Lewisohn* case the property was acquired outright by the promoters—there was nothing in the way of a "shoe-string" transaction which would indicate a lack of good faith. Not as much can be said for the defendants in the *Furlaud* case. They took only options on the gas lands, and when first acquired these options were gratuitous. It is true that $45,510 was later paid "to give them binding force", but in proportion to the magnitude of the Duquesne project, the promoters' risk assumed at the outset was almost inconsequential. Liability can more readily be found on that account;[32] the promoters' motives in acquiring the property are more open to suspicion than in the *Lewisohn* case.[33]

A related consideration, also bearing on the amount of risk which the promoters undertook and the consequent light thrown on their motives, has to do with the promoters' subscription to the the authorized capital stock. In the *Lewisohn* case the mining syndicate formed by the promoters retained thirteen-fifteenths of the total stock, only two-fifteenths being subscribed by the general public. To Justice Holmes this was evidence at least that they "believed in the enterprise" and had no deliberate plan to defraud.[34] The Furlaud interests took but 140,000 out of 1,250,000 authorized no-par shares, approximately one-ninth of the total capital stock. At the rate of 50¢ a share, they paid for the stock only $70,000. In the further financial jugglery that followed, they received an additional 535,000 shares as a "bonus". For an outlay of $70,000 they had acquired, at the 50¢ rate, $337,500 worth of stock. The rapidity with which they disposed of the complete block through stock operators for $850,000 manifested clearly that to them a $780,000 profit in pocket from this portion of their scheme was vastly preferable to exhibiting any further "belief in the enterprise". In this respect, too, the *Lewisohn* promoters invited judicial wrath less openly than did those in the *Furlaud* case.

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31. Victor Oil Co. v. Drum, 184 Calif. 226, 193 Pac. 243 (1920); Densmore Oil Co. v. Densmore, 64 Pa. 43 (1870). Length of time the promoters have held the property and uses to which promoters have put property are other facts disclosing the promoters' intention in acquiring the property which they transferred to the corporation. *Cf.* Russell v. Rock Run Fuel Gas Co., 184 Pa. 102, 39 Atl. 21 (1898) and Milwaukee Cold Storage Co. v. Dexter, 99 Wis. 214, 74 N. W. 976 (1898).

32. *Cf.* Victor Oil Co. v. Drum, 184 Calif. 236, 193 Pac. 243 (1920); Clark v. Daniels, 250 Mich. 22, 229 N. W. 495 (1930).

33. "Options" entered into the Lewisohn case only to a limited, uninfluential extent: "Bigelow and Lewisohn, in May and June, 1895, obtained options . . . for the purchase of the stock and the property. . . . They also formed a syndicate to carry out their plan, with the agreement that the money subscribed by the members should be used for the purchase and the sale to a new corporation, at a large advance, and that the members, in the proportion of their subscriptions, should receive in cash or in stock of the new corporation, the profit made by the sale. On May 28, 1895, Bigelow paid . . . for . . . stock on behalf of the Syndicate, in cash and notes of himself and Lewisohn, and in June Keyser (another vendor) was paid in the same way." A month or so after full payment for the purchased property had taken place, Old Dominion Co. came into existence. Old Dominion Copper Mining and Smelting Co. v. Lewisohn, 210 U. S. 206, 210 (1908).

34. *Id.* at 215. *Cf.* McCandless v. Furlaud, 56 Sup. Ct. 41, 46 (1935).

The way in which the suit arises may influence the result. In the *Lewisohn* case the suit was brought by the corporation against the promoter; no creditors were involved. The *Furlaud* case arose as an action by a receiver, representing the holders of bonds and notes—creditors. The significance of the entrance of creditors into the picture will be further discussed presently. Meanwhile it should be observed that one more differentiating factor exists. There is the Pennsylvania constitutional provision, forbidding fictitious issuance of stock or bonds,[35] in the *Furlaud* case; it had no counterpart in the *Lewisohn* litigation. Governing public policy, as exemplified by such provisions in statutes or constitutions, may often be a factor of great weight.[36] There are other factors which enter into a consideration of cases of this sort,[37] but only those which are directly involved in comparing the *Lewisohn* and *Furlaud* decisions have been indicated here. Probably the most important for this purpose concerns the nature of the interests affected, particularly whether the interests are those of shareholders or creditors, and whether in either case the status has been acquired at the time of the protested action, or not until shortly after the malefactions have been completed. It is in regard to this aspect of the problem that the most striking shift in the Court's attitude is revealed.

It has already been pointed out that no creditors were involved in the *Lewisohn* case. Imminently prospective shareholders were denied recovery.[38] In the *Furlaud* case the bonds and notes were all distributed by

35. PA. CONST. (Purdon 1930) art. xvi, § 7.

36. *Cf.* Note (1929) 77 U. OF PA. L. REV. 661, 666, 667; Berle, *Compensation of Bankers and Promoters Through Stock Profits* (1929) 42 HARV. L. REV. 748.

37. For example, in a particular case the following additional factors may be important:
a. Time of promoter's subscription. Did he subscribe before incorporation or after?
b. Degree of knowledge of other members of the association of the promoter's profits. Will pre-incorporation subscribers be considered shareholders for this purpose?
c. Extent of promoter's control over the enterprise at the time the property was transferred to the corporation. Were there independent directors? Was the profit scheme executory or executed?
d. Degree of knowledge of those in control if promoters were not in control. How much did the independent board know?
e. Characterstics or incidents of shares subscribed to by promoters. Par or no-par? Voting or non-voting? Will the promoters always be protected if they receive no-par shares in return for their property? Will the court value no-par shares at the average price the public pays for the shares, or the price at which the promoters unload the shares on their transferees?
f. Length of time between transfer of the property to the corporation by the promoters, and suit against the promoters. Will laches or unreasonable delay preclude a recovery against the promoters even though all the elements usually necessary for a recovery are present? Will delay in instituting suit be taken to be evidence of shareholder's ratification of the promoter's conduct?
g. Character of the remedy sought. Rescission or damages? If the remedy of damages is asked, what is the measure? For cases involving some of the above considerations, see Beal v. Smith, 46 Cal. App. 271, 189 Pac. 341 (1920); Henderson v. Plymouth Oil Co., 16 Del. Ch. 347, 141 Atl. 197 (1928); Piggly Wiggly Delaware, Inc. v. Bartlett, 97 N. J. Eq. 469, 129 Atl. 413 (1925); Allenhurst Park Estates v. Smith, 101 N. J. Eq. 581, 138 Atl. 709 (1927); Pittsburgh Mining Co. v. Spooner, 74 Wis. 307, 42 N. W. 259 (1889); Erlanger v. New Sombrero Phosphate Co., 3 App. Cas. 1218 (1878); Gluckstein v. Barnes, [1900] A. C. 240.

38. A contrary result was reached in Old Dominion Copper Co. v. Bigelow, 188 Mass. 315, 74 N. E. 653 (1905). Compare this case with a later Massachusetts case absolving promoters for non-disclosure of profit to persons purchasing shares from them. Hays v. The Georgian, Inc., 280 Mass. 10, 181 N. E. 765 (1932), 85 A. L. R. 1262 (1933), criticised by Berle, *supra* note 36, at 756, 757.

Duquesne to Furlaud and Kingston before they reached the hands of the public; hence the creditors acquired their status through transfers from the promoting interests, and not through direct dealings with the corporation issuing the securities. In the same sense that the shareholders in the *Lewisohn* case were merely prospective at the time of the promoters' wrong, the creditors in this later case may be described as prospective only at that time. It is true that a case withholding protection from potential shareholders does not necessarily preclude granting protection to potential creditors. But there is a common factor in the two situations in that prospective interests are involved. To consider such interests would have seemed to the Court in the *Lewisohn* case to be "strictly legislative." [39] In the *Furlaud* case comes the announcement that "the interests affected by approval will shape the power to approve",[40] and that the "assent" of those who are shareholders at the time of the wrong cannot in all cases close the door of the courts to those acquiring interests shortly thereafter. If any doubt lingered as to the reversal of the Court's views, it was dispelled when Justice Cardozo stated: "The shareholders were not at liberty, at all events to the prejudice of creditors *or other shareholders, present or prospective,* to set that policy at naught. If the effect of what they did was to put illicit profits in the pockets of trustees, their consent will not avail to block pursuit and reclamation." [41]

Conclusion

Whether the Supreme Court today would reach the same result if the identical facts of *Old Dominion Copper Co. v. Lewisohn* were presented cannot, in view of the above consideration of the problem, be categorically answered. But *McCandless v. Furlaud* makes a very real contribution to the problem of promoters' liability, even though it does not in all respects overrule the *Lewisohn* decision. For one thing, there is now a specific recognition from the highest tribunal that the interest of the community as a whole, as set forth in a constitutional provision, is a factor of considerable import in affixing the responsibility of promoters. And a more striking advance is made in regard to the interests of prospective shareholders and creditors. Under the *Lewisohn* case they were apparently doomed to complete disregard. There is now an assurance that, at least in sufficiently compelling circumstances of promotional abuse, these interests will be given adequate judicial protection.

M. P. R.

39. 210 U. S. 206, 215 (1908).
40. Instant case at 46.
41. *Id.* at 48. Italics added.